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No. .....

In the Supreme Court of the United States

October Term, 1983

THE PUBLIC UTILITY COMMISSIONER OF OREGON, THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, THE IDAHO PUBLIC UTILITIES COMMISSION, THE PUBLIC SERVICE COMMISSION OF NEVADA and THE PUBLIC SERVICE COMMISSION OF WYOMING

Petitioners,

v.

PHILLIPS PETROLEUM COMPANY, AMOCO PRODUCTION COMPANY, GETTY OIL COMPANY, MOBIL OIL CORPORATION, ATLANTIC RICHFIELD COMPANY, CHAMPLIN PETROLEUM COMPANY and T. H. McELVAIN, *et al.*,

Respondents.

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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Question Presented

Did the court of appeals deprive western gas consumers of the regulatory protection to which they are entitled under § 1(b) of the Natural Gas Act, 15 U.S.C. § 717(b), by determining that San Juan Basin lease-sale agreements, which were the economic equivalent of regulated producer-pipeline wellhead gas sales contracts and which "accomplished the transfer of large amounts of natural gas to an interstate pipeline company for resale in other states", were not jurisdictional sales in place of proven reserves under *Rayne Field* (*United Gas Improvement Co. v. Continental Oil Co.*, 381 U.S. 392 (1965)), and *Ship Shoal* (*Continental Oil Co. v. FPC*, 370 F.2d 57 (5th Cir. 1966)), *cert. denied*, 388 U.S. 910 (1967)), solely because this major western gas supply of proven reserves had not also been "substantially developed" according to a well-counting test which compared as to each lease sale "the actual number of wells" in the ground to "the number needed to deplet[e] the acreage."

LIST OF PARTIES

Public Agencies:

Federal

Federal Energy Regulatory Commission

State

People of the State of California
Public Utilities Commission of the State of California
Idaho Public Utilities Commission
Public Service Commission of Nevada
Public Utility Commissioner of Oregon
Washington Utilities & Transportation Commission
Public Service Commission of Wyoming

City

City of Ellensburg, Washington

Interstate Natural Gas Pipeline Companies:

El Paso Natural Gas Company
Northwest Pipeline Corporation

Distribution Companies:

Cascade Natural Gas Corporation
Colorado Interstate Gas Company
C.P. National Corporation
Intermountain Gas Company
Mountain Fuel Supply Company
Northwest Natural Gas Company
Pacific Gas and Electric Company
Rocky Mountain Natural Gas Company
San Diego Gas & Electric Company
Southern California Edison Company
Southern California Gas Company
Southern Union Company
Southwest Gas Corporation
Washington Natural Gas Company
Washington Water & Power Company

Producers:

El Paso's System	Party
GLA 47	Tenneco Oil Company
	Conoco, Inc.
GLA 51	Mapco, Inc.
	Hopi Oil Company
GLA 52	Tenneco Oil Company
	Conoco, Inc.
GLA 60	Tenneco Oil Company
	Conoco, Inc.
	Charles Colwill
	Anne Home Emerson, Trustee
	Anna Lou Home
	Jean E. Keyser
	Cassandra Keyser
	Teresa Home
	Barron Kidd
	Helen Ulmer van Atta
GLA 61	Sun Oil Company (Delaware)
GLA 62	FHN, Ltd.
GLA 63	Atlantic Richfield Company
GLA 66	W. Watson LaForce, Jr.
	Henry P. Isham, Jr. Estate
	Robert T. Isham
	Josephine C. Jacobson
	J. Roberts Jones
	Nancy LaForce Keyes
	Frederic P. G. Lattner, Trustee, U/T Martha M. Lattner, Settlor
	Suzanne LaForce Baber
	James C. Bard
	Douglas N. Bard
	Ralph A. Bard, Jr.
	Roy E. Bard, Jr.
	G. Brainard, Jr. Trust
	Continental Illinois National Bank and Trust Company, Trustee Trust No. 23935

El Paso's System	Party
	Continental Illinois National Bank and Trust Company, Trustee Trust No. 23949
	Eleanor Isham Dunne
	Charles W. Farnham, Jr.
	Robert B. Farnham
	Walter B. Farnham
	Elizabeth B. Farrington
	Minnie A. Fitting
	R. U. Fitting, Jr. Estate
	Robert D. Fitting
	Nancy H. Gerson
	John R. Grimes
	Ruth N. Halls
	Cortland T. Hill
	Elsie F. Hill
	Louis W. Hill, Jr.
	Albert L. Hopkins, Jr.
	George S. Isham
	R. S. MacDonald, A. MacDonald and Northern Trust Co., Trustees U/W of N.S. MacDonald, Deceased
	Mary F. Love
	William J. McDermott, Trustee
	Nora R. Ranney
	Catherine H. Ruml
	Edward L. Ryerson, Jr.
	Sabine Royalty Corporation
	Shaw, Isham & Company
	John I. Shaw, et al., Trustee
	James Simpson, Jr. Trust
	William E. Simpson Trust
	Sydney Stein, Jr.
	Northern Trust Co., Trustee, U/W of John Stuart
	Robert Douglas Stuart Estate
	William P. Sutter
	Michael Simpson Trust
	Patricia Simpson Trust
	Katharine I. White

El Paso's System	Party
	Kay B. Gundlach
	Frederick F. Webster Trust
	Mary S. Zick
	David Waller Dangler
GLA 72	Mapco, Inc.
	Hopi Oil Company
GLA 76	Union Oil Company of California
	First National Bank of Ft. Worth, Trustee for Eula May Johnston
	James J. Johnston
	V. A. Johnston Family Trust
	Jones Company
	Wm. C. McMahan Estate
	Homer R. Stasney & Sons Company
	Rogers-Gibbard Trust
GLA 77	Robert Beamon
	Robert Beamon, Trustee
	Pattie Ann Beamon Lundell
	Thomas L. Hall, Trustee
GLA 78	American Petrofina Company
	Tenneco Oil Company
	Conoco, Inc.
GLA 86, 101, 127	Mapco, Inc.
	Hopi Oil Company
GLA 106	Morris and Flora Mizel
GLA 122	Producing Royalties, Inc.
	Harold S. Long
	Dixie M. McLane, Trust
	Mrs. Judy St. John Taylor
	John S. White
GLA 125	American Petrofina Company
	Anderson Construction Company, Inc.
	Benson-Montin-Greer Drilling Corp.
	Tom Bolack
	Oliver Benson
	Albert R. Greer
	Mary Eddy Jones

El Paso's System	Party
	Edna Fern Benson
	Walter Benson
	Charlene K. Greer
	Mary E. Jones and The First National Bank & Trust Company of Oklahoma City, Trustees U/W of F. Jones
	Late Oil Company
	A.C.Montin, Jr.
	William V. Montin
	Oklahoma and Northwestern Company
GLA 129	Delta Drilling Company
	Trustees of the DeGolyer Foundation
	Mrs. Nell V. DeGolyer
GLA 139	Producing Royalties, Inc.
	James A. and Hazel H. Borland
	R. Lewis Chandler Trust
	Marcy C. Fannin
	Charles E. Graham, Jr.
	Newell R. Hays
	Dixie M. McLane Grandchildren's Trust
	Critchell Parsons
	Judy St. John Taylor
GLA 152, 160, 231	J. Glenn Turner
	Sue Reeder Turner Trust
	William G. Webb
GLA 153	Gretchen A. Gartner
	Helen L. Harvey
GLA 157	Mapco, Inc.
	Barbara Ann Bruss
	O. J. Lilly
	Barbara Irene McConnell
GLA 172	Crown Central Petroleum Corporation
GLA 195	William G. Webb
GLA 196	J. Glenn Turner
	Sue Reeder Turner Trust
	William G. Webb
	Benson-Montin-Greer Drilling Corp.

El Paso's System	Party
	Barbara Ann Bruss
	Charles Albert Greer
	La Plata Gathering System, Inc.
	O. J. Lilly
	Huerfanito Gas Co., et al., PP
	Barbara Irene McConnell
	Mary R. Boecking and H. E. Boecking, Jr., Trustees
	Jacqulyn M. Williams
GLA 197	Huerfanito Drilling Company, Inc.
GLA 198, 248	J. Glenn Turner
	Sue Reeder Turner Trust
	William G. Webb
	Frank A. Schultz
GLA 249	Benson-Montin-Greer Drilling Corp.
	Barbara Ann Bruss
	Charles Albert Greer
	La Plata Gathering System, Inc.
	O. J. Lilly
	Barbara Irene McConnell
	Mary R. Boecking and H. E. Boecking, Jr. Trustees, U/T of Mary M. Strachley
	J. Glenn Turner
	Sue Reeder Turner Trust
	Jacqulyn M. Williams
GLA 348	Union Oil Company of California
	Jones Company
	W. C. McMahan
	H. R. Stasney & Sons Company
GLA 349	Union Oil Company of California
GLA 350, 351	Robert Beamon
	Robert Beamon, Trustee
	Thomas L. Hail, Trustee
	Pattie Ann Beamon Lundell

Northwest's System	Party
PLA 2	Atlantic Richfield Company
PLA 3	Getty Oil Company
PLA 4	Grace M. Brown
	Catherine B. McElvain, Inc. and as Executive of Estate of T. H. McElvain, Deceased
	T. H. McElvain Oil and Gas Properties
	James E. McElvain, Executor of Estate of Carl R. McElvain
	J. Wm. McElvain
	Estate of F. B. Miller
	Mabelle McElvain Miller
	Mrs. Ruth M. Vaughn
PLA 5	Phillips Petroleum Company
PLA 6	Amoco Production Company
	J. Ralph Ellis, Jr.
	Jones Felvey, II
	First National Bank in Dallas for the Acct. of J. Ralph Ellis, Jr.
	McCulloch Oil Corporation
	Mountain States Natural Gas Corp.
	John D. Mugg, Jr.
	Jack B. Ryan
	Texas Oil & Gas Corp.
	U. V. Industries
PLAs 7, 9, 10, 11	Amoco Production Company
PLA 8	J Ralph Ellis, Jr.
	Jones Felvey, II
	First National Bank in Dallas for the Acct. of J. Ralph Ellis, Jr.
	H. M. Meredity Trustee and First National Bank of J. Ralph Ellis, Jr.
	Mountain States Natural Gas Corp.
	John D. Mugg, Jr.
	Amoco Production Company
	Jack B. Ryan
	Texas Oil & Gas Corp.
PLA 13	Mobil Oil Corporation
PLA 14	Champlin Petroleum Co.

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PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Petitioners, the Public Utility Commissioner of Oregon, the Washington Utilities and Transportation Commission, the Idaho Public Utilities Commission, the Public Service Commission of Nevada, and the Public Service Commission of Wyoming (hereinafter "the Western State Petitioners"), respectfully pray that writs of certiorari issue to review the judgments of the United States Court of Appeals for the Fifth Circuit (former Fifth), entered on July 5, 1983, in *El Paso Natural Gas Co. v. Sun Oil Co.*, No. 77-1762, and *Tenneco Oil Co. v. FERC*, No. 80-2404.

OPINIONS BELOW

The Judgments of the court of appeals are printed at Appendix 145a and 149a.[1] The opinion of the court of appeals is reported at 708 F.2d 1011 (5th Cir. 1983), and is printed at App. 1a-19a. The court of appeals' order of December 2, 1983, denying petitions for rehearing and suggestions of rehearing en banc is unreported, but is printed at App. 151a-152a.

The court of appeals reversed a decision of the Federal Energy Regulatory Commission (the "FERC" or the "Commission") (No. 80-2404), and affirmed a decision of a federal district court (No. 77-1762). The Initial Decision of the FERC Administrative Law Judge (ALJ), *El Paso Natural Gas Co.*, 6 F.E.R.C. ¶ 63,037 (1979), is printed at App. 33a-120a. The Commission's Order

[1] **The Western State Petitioners refer to the separate Appendix ("App.") filed on February 9, 1984, by petitioners in People of the State of California, et al. v. Tenneco Oil Co., et. al., Docket No. 83-1321, which contains the judgments below and all judicial and administrative opinions issued in this matter.**

Affirming Initial Decision and Initiating Further Hearing, *El Paso Natural Gas Co.*, 12 F.E.R.C. ¶ 61,296 (1980), is printed at App. 21a-31a. The Commission's Order Denying Applications for Rehearing, 13 F.E.R.C. ¶ 61,239 (1980), is printed at App. 153a-154a. The decision of the district court, *El Paso Natural Gas Co. v. Sun Oil Co.*, 426 F.Supp. 963 (W. D. Tex. 1977), is printed at App. 121a-136a. An earlier decision of the Fifth Circuit, *Tenneco Oil Co. v. FERC*, 580 F.2d 722 (5th Cir. 1978), wherein the court of appeals concluded it should not decide the appeal from the district court until it had the benefit of the FERC decision, is printed at App. 137a-141a.

JURISDICTION

1. The court of appeals held that the lease-sale transfers at issue were not sales for resale under § 1(b) of the Natural Gas Act (NGA), 15 U.S.C. § 717b. This ruling reversed an FERC determination that the transfers were jurisdictional sales under § 1(b) and affirmed an earlier contrary district court ruling. The FERC had jurisdiction under §§ 4, 5, 7, 8, 14 & 16 of the NGA, 15 U.S.C. §§ 717c, d, f, g, m & o. The district court's jurisdiction rested on 28 U.S.C. § 1331 and § 22 of the NGA, 15 U.S.C. § 717u.

2. The court of appeals entered judgment on July 5, 1983, and denied rehearing on December 2, 1983. This petition is timely under 28 U.S.C. § 2101(c). This Court's jurisdiction is invoked under 28 U.S.C. § 1254 (1) and § 19(b) of the NGA, 15 U.S.C. § 717r(b).

FEDERAL STATUTE INVOLVED

Section 1(b) of the NGA, 15 U.S.C. § 717(b) provides:

> The provisions of this act shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption or domestic, commercial, industrial, or any other use, and to natural gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

STATEMENT OF THE CASE

1. Statement of Facts

This petition presents for review the court of appeals' erroneous reversal of the Commission's assertion of NGA jurisdiction over lease-sale agreements under which large volumes of natural gas have been produced for nearly 30 years for gas consumers in eight western states by two major interstate pipelines, Northwest Pipeline Corporation (Northwest) and El Paso Natural Gas Company (El Paso), from the San Juan Basin of New Mexico and Colorado.

The Initial Decision of the ALJ, adopted by the Commission, sets forth the relevant history of the San Juan Basin and the crucial history of the lease-sale agreements. App. 74a-86a. A brief synopsis of the controlling facts is set forth below:

The Pacific Northwest States of Oregon, Washington and Idaho, with no significant indigenous gas reserves, remained the last major geographic area in the United States without natural gas. These states finally obtained natural gas service on September 1, 1956, when Pacific Northwest Pipeline Corporation (PNW), the predecessor of Northwest, completed a major new interstate pipeline system and began delivering large volumes of natural gas from the San Juan Basin to them and to Northern Nevada together with supplementary gas supplies to the States of Colorado, Utah and Wyoming.

PNW was organized in 1950 and began seeking the large volume of gas reserves needed to justify building a pipeline to supply the Pacific Northwest. In 1952, PNW filed an application for a Federal Power Commission (FPC) certificate to build its pipeline from the San Juan Basin which was then recognized as a major source of natural gas. There had been natural gas production in the San Juan Basin for a small New Mexico market for many years, but extensive expoitation of the Basin's immense reserves did not begin until 1950 when the FPC authorized El Paso to build an interstate pipeline to deliver San Juan Basin gas to California. El Paso expeditiously developed its San Juan system to California and acquired much of the gas needed for the California market by purchasing San Juan reserves in place under certain lease-sale agreements called Gas Lease Agreements (GLAs).

PNW was a promotional venture that needed to raise from lenders and investors the substantial capital

necessary to build the long pipeline north from the Colorado-New Mexico border through the Rocky Mountains to Boise, Idaho and then west to Portland, Oregon and Seattle, Washington with lateral connections to new intrastate distribution companies which would serve the population centers of the Pacific Northwest and to existing distributors already serving the other western states. In order to make its proposed system a reality, PNW had to demonstrate to lenders and the FPC that it could buy the extensive gas reserves required and sell sufficient volumes in the new market areas to make its pipline construction and operations economic and in the public interest.

The principal supply for the new PNW system was obtained by a series of lease-sale agreements, patterned on El Paso's GLAs, called Pacific Lease Agreements (PLAs). To acquire the necessary reserves, PNW had to offer an option to the San Juan producers to either purchase their gas at the wellhead or purchase their reserves in place by lease-sale. Under PNW's option proposal the San Juan producers would receive as much or more in net income for their gas under the in-place reserve sale as they would under a conventional wellhead sale. With assured economic equivalency, the San Juan producers, like the producers in *Rayne Field*, chose to sell their reserves in place through a lease-sale rather than at the wellhead in the belief that they thereby would avoid regulation under the NGA.

Conditional "commitments" of the trillions of cubic feet of natural gas that were required and which became

the PLAs were obtained by PNW from Phillips Petroleum Company (Phillips) and other San Juan Basin producers, including the predecessors of Amoco Production Company, Getty Oil Company, Atlantic Richfield Company and Mobil Oil Corporation. These initial agreements began to be executed in 1952 and were expressly conditioned on PNW obtaining project financing to construct its proposed system and FPC certification. Both certification and financing in turn were dependent upon proof to the Commission and to lenders that the PLA properties contained sufficient proven and available gas reserves to support PNW's proposed new natural gas service to the Pacific Northwest. In its conditional agreement with PNW, Phillips represented that its approximately 200,000 San Juan acres contained large reserves of natural gas and agreed to pursue at its expense a selective drilling program to extend the proven reserve field limits to establish the presence of at least 2.5 trillion cubic feet (Tcf) of proven reserves.

Several months after executing the conditional agreement, Phillips selectd the lease-sale of reserves in place option and executed a conditional assignment to PNW which became known as the lease-sale agreement, PLA-5. Under PLA-5, Phillips conditionally agreed to transfer 2.5 trillion cubic feet (Tcf) of gas reserves to PNW, reserving a "special overriding" royalty,[2] once a FPC

[2] The special overriding royalty reserved by Phillips and the other producers under the PLAs was payable on the entire production except that production attributable to the base royalty (12½%) and any other percentage overriding royalty (typically 5% or less). Thus the special overriding royalty is payable on 80% or more of the total gas volumes and covers all of the net interest.

certificate was issued, financing for the PNW system had been obtained and PNW had paid Phillips for all existing wells and equipment. Thereafter, PNW was obligated to develop the acreage rapidly and to acquire from the San Juan Basin all of its daily gas requirements up to 350 million cubic feet (MMcf) per day, so that Phillips would be assured of substantial payments as soon as the new pipeline was completed and continuously thereafter.[3] PLA-5 established the pattern for the other lease-sale agreements that PNW executed with San Juan producers.

In June 1954, the FPC granted PNW a certificate to build its new pipeline conditioned on PNW's obtaining financing to construct the pipeline. *Northwest Natural Gas Co.*, 13 F.P.C. 221 (1954). Relying on several expert reserve estimates, lenders and investors committed $160 million, secured by the PLA reserves. The Commission approved PNW's financing plan on February 11, 1955, thereby making PNW's certificate final and enabling PNW to close the PLA agreements. The PLA reserves were not actually transferred, however, until May 4, 1955, when PNW obtained the funds needed to construct its pipeline and to pay the producers for the existing wells and equipment. Seven San Juan producers then transferred some 344,210 acres to PNW pursuant to eleven PLA agreements to provide the principal gas supply for its new Pacific Northwest market. At the time of transfer, there were 124 wells on or communitized

[3] Under PLA-5, PNW was required to develop the acreage so that there would be 250 net wells by July 1, 1955. The 350 MMcf daily take obligation required PNW to serve its market from the San Juan Basin because this daily volume exceeded the initial design capacity of the pipeline. See App. 77a.

with the PLA acreage, for which PNW paid the PLA producers $7.5 million.[4]

After the leases were assigned and the reserves transferred to PNW in May 1955, the new PNW pipeline system was quickly constructed and additional wells were drilled to supply the initial market demand. During the first year after the PLAs were closed in 1955, PLA acreage produced 12.61 Bcf of gas for the interstate market. Interstate service from the PLA acreage to gas consumers in the Pacific Northwest began on September 1, 1956.[5] During 1957 — the first full calendar year of system operation — PNW produced over 30 Bcf from the PLA reserves. The PLA reserves have continued for over 25 years to be a principal supply for Northwest's market area with production in recent years averaging about 25 Bcf annually.

2. Proceedings Below

This dispute regarding the jurisdictional status of the PLAs and GLAs arose in 1973 when an arbitration award increased El Paso's overriding royalty payment obligation under one of its GLAs held by Sun Oil Company from 10¢ per thousand cubic feet (Mcf) to 40¢ per Mcf, a price substantially above the price then allowed by the Commission for comparable vintage natural

[4] Phillips received $5.6 million of this amount for 75 wells it had drilled on the PLA-5 acreage. During 1964, Phillips produced and made jurisdictional sales of 1.35 billion cubic feet (Bcf) from those wells.

[5] The twelfth PLA agreement at issue here (PLA-13), was not executed until April 1957, after PNW's pipeline was in operation. It is presently held by Mobil Oil Corporation.

gas.[6] The special overriding royalties had risen gradually from 5½¢ per Mcf in the early 1950s for the GLAs and 7¢ per Mcf in the mid-1950s for the PLAs to 10¢ per Mcf by the late 1960s.

El Paso filed a federal action against the San Juan producers who were demanding the 40¢ per Mcf price seeking a declaration that the lease-sales constituted jurisdictional sales under the NGA. El Paso also filed a complaint with the Commission seeking a jurisdictional determination. Northwest, having recently acquired the PLA agreements from El Paso under this Court's divestiture mandate, intervened in the district court action which involved only one PLA and filed a complaint with the Commission seeking a jurisdictional determination of all of the PLAs. In 1977, the district court decided that the GLAs and the one PLA before it were not jurisdictional sales. App. 121a-136a.

The Commission withheld action on the two complaints pending conclusion of the district court action, but then instituted its own consolidated proceedings cov-

[6] Because these "special overriding royalties" burden the net interest (approximately 80%) of the trillions of cubic feet of this important western gas supply, the quadrupling of the royalty, if implemented, would have severely impacted western gas prices. To protect their economic viability, Northwest and El Paso negotiated settlement agreements with the PLA and GLA producers effective in 1974, subject to refunds if the PLAs and GLAs were determined to be jurisdictional. These agreements tied the special overriding royalties to the highest regulated rates rather than prices prevailing in the unregulated intrastate market. Even this highest regulated rate escalated rapidly so that by June 1982 the price required to be paid under the settlement agreements between the pipelines and the PLA and GLA producers was $3.44 per Mcf rather than the $.52 per Mcf regulated rate for gas of vintage comparable to PLA and GLA production.

ering all of the PLA and GLA agreements. The Western State Petitioners intervened in the FERC proceedings because gas consumers in their states faced serious economic injury if the special overriding royalty demands of the PLA producers were not limited to jurisdictional sales prices. In 1979, after a lengthy evidentiary hearing, the ALJ issued an Initial Decision finding that all of the PLAs and GLAs constituted jurisdictional sales of natural gas. App. 33a-120a. In 1980, the Commission adopted the ALJ's decision and affirmed. App. 21a-31a.[7]

Consolidated appeals from the conflicting decisions of the district court and the Commission were argued before a panel of the former Fifth Circuit in October 1981. The court of appeals decision, issued July 5, 1983, reversed the Commission's jurisdictional determination and affirmed the district court's contrary holding. App. 1a-19a. Timely petitions for rehearing filed by the FERC, the Western State Petitioners and other parties were denied on December 2, 1983.

REASONS FOR GRANTING THE WRITS

The court of appeals' reversal of the Commission's jurisdictional determination erroneously deprives western gas consumers of the regulatory protection to which they are entitled under the NGA. The decision below

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[7] In addition to affirming the jurisdictional determination, the FERC initiated remedy proceedngs to determine the proper jurisdictional rates for the PLA and GLA gas and the amount the producers should be required to refund to the pipelines' customers. After two years of discovery and preparation the remedy trial was set to commence in September 1983, but was suspended following the court of appeals' decision.

is at war with this Court's expansive construction of Commission jurisdiction in *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954), and *United Gas Improvement Co. v. Continental Oil Co.* ("*Rayne Field*"), 381 U.S. 392 (1965). In holding that there must be a substantial number of development wells on the acreage at the time lease-sale agreements are executed for the Commission to have jurisdiction, the decision below is both unsound and irreconcilable with Judge Wisdom's long standing, well-reasoned application of *Rayne Field* to a proven but undeveloped field in *Continental Oil Co. v. FPC* ("*Ship Shoal*"), 370 F.2d 57 (5th Cir. 1966), *cert. denied*, 388 U.S. 910 (1967), on which the Commission rightly relied in making its jurisdictional determination. App. 31a, 104a-114a.

The decision below inflicts substantial and continuing economic injury on gas consumers in the eight western states served by Northwest and El Paso. By the FERC Staff's estimate, gas consumers in the Pacific Northwest were forced to pay the PLA producers, through Northwest's cost of service, some $175 million more than they should have paid from 1974 through 1982 had the PLA overriding royalties been subject to federal price regulation. The Western State Petitioners and Northwest were attempting to recover these overpayments for the benefit of western gas consumers in the remedial phase of the Commission's procedings when those proceedings were aborted due to the Fifth Circuit's decision.

Under the decision below, western gas consumers have no remedy for the substantial overcharges they have

paid to the San Juan producers and Northwest and its customers also face potentially enforceable royalty demands greatly exceeding federal ceiling prices for future PLA production.[8] Because this decision erroneously restricts the scope of consumer protection under the NGA, deprives western gas consumers of the regulatory protection to which they are entitled, denies them a remedy for substantial past overcharges and threatens them with continuing overcharges in the future, this case is of exceptional public importance and warrants this Court's review.

THE DECISION BELOW UNDERCUTS THIS COURT'S DECISION IN *PHILLIPS* AND *RAYNE FIELD* THAT ALL WHOLESALES OF NATURAL GAS AND THEIR ECONOMIC EQUIVALENTS ARE TO BE REGULATED FOR THE PROTECTION OF THE CONSUMER.

In *Phillips,* this Court held that the Commission had jurisdiction under § 1(b) to regulate the rates charged by producers in wellhead sales for resale in interstate commerce. The *Phillips* Court rejected the producers' contention that field sales were excluded from Commission jurisdiction by the "production or gathering" exemption of § 1(b), and it emphasized that "exceptions to the primary grant of jurisdiction in the section [1(b)] are to be strictly construed, . . ." 347 U.S. at 679 (quot-

[8] Northwest and Phillips recently have concluded a settlement which provides that if PLA-5 is ultimately held to be jurisdictional by this Court Phillips will refund some $30 million and be possibly required to accept a lower royalty rate in the future than that negotiated in the settlement agreement.

ing *Interstate Natural Gas Co. v. FPC*, 331 U.S. 682, 690-91 (1947)). The Court stressed that Congress intended "to give the Commission jurisdiction over the rates of *all wholesales* of natural gas in interstate commerce, . . ." 347 U.S. at 682 (emphasis added).

In *Rayne Field*, this Court reaffirmed that holding. *Rayne Field* was precipitated by the attempt of natural gas producers to avoid regulation by selling gas reserves not at the well head but in place through lease-sale transactions which followed the pattern set by the earlier GLAs and PLAs. Producers then still believed that under *FPC v. Panhandle Eastern Pipeline Co.*, 337 U.S. 498 (1949), a lease-sale transaction was beyond the scope of Commission jurisdiction as defined by *Phillips* regardless of the economic substance of the lease-sale transaction. The *Rayne Field* Court emphatically laid that notion to rest. Limiting *Panhandle* to its facts,[9] the Court held that the economic substance, not the form of the transaction, controls and that a case-by-case analysis of the economic realities of lease-sale transactions must be undertaken. Where lease-sales are "in most respects, equivalent to conventional sales of natural gas", 381 U.S. at 401, and the "significant and determinative

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[9] **Panhandle** concluded that lease-sales come under the "production or gathering" exemption of § 1(b) because "[o]f course leases are an essential part of production." 337 U.S. at 505. The Court in **Rayne Field** responded that "[t]he language of **Panhandle** is unquestionably broad. But flat statements such as '[of] course leases are an essential part of production,' . . . should not be taken to cover more than the particular kind of leases that were before the Court . . . ." 381 U.S. at 404. Thus, **Rayne Field** limited the application of **Panhandle** to its unque facts: the transfer by an interstate pipeline of leases covering an undeveloped field to a production company for intrastate sale and consumption. **Id.** at 403-04.

economic fact" is that the lease-sales "accomplish[ ] the transfer of large amounts of natural gas to an interstate pipeline company for resale in other States," *id.*, the Commission must have jurisdiction. A contrary result, the Court concluded, would "substantially undercut *Phillips*", *id.*, and deprive consumers of the "protection . . . against exploitation at the hands of natural gas companies that was the primary aim of the Natural Gas Act." *Id.* at 402 (quoting *Phillips*, 347 U.S. at 682). *Phillips* and *Rayne Field* made clear that Congress intended to regulate all interstate wholesales of gas without exception.

The Commission found and the court below acknowleged that the PLA and GLA lease-sales were the economic equivalent of ordinary wellhead sales, that the transfer of reserves to PNW and El Paso was for the purpose of interstate transmission for resale and that the huge PLA and GLA reserves transferred were proven within reasonable estimates at the time of transfer. But, counting the number of development wells on the various leases at the time the agreements were signed rather than focusing on the economic realities at the time the proven reserves were transferred, the court concluded that the reserves wre not substantially developed and thus the lease-sales were not jurisdictional sales.

The decision below seriously undercuts *Phillips* and *Rayne Field* and is a throwback to the form-over-substance philosophy of *Panhandle* on which it relies. Disregarding the express language of *Phillips* and *Rayne Field* the lower court narrowly interpreted their jurisdictional reach and broadly interpreted *Panhandle's* jurisdictional exemption. The result was based on an erroneous and

outdated approach to construction of the NGA. The court below stated, "If Congress had intended to regulate the transactions involved, it easily could have done so with simple statutory language." App. 5a. But that rule of statutory construction is in direct conflict with *Phillips* and *Rayne Field* and would have required a contrary result in those two landmark cases. Commission jurisdiction under § 1(b) is to be viewed liberally. Exceptions to that jurisdiction are "to be strictly construed." *Phillips*, 347 U.S. at 679. *See FPC v. Louisiana Power & Light Co.*, 406 U.S. 621, 631 (1972).

Contrary to the teachings of *Rayne Field*, the court of appeals ignored the economic realities of the PLA transactions that compel a jurisdictional determination. When the PLA reserves were transferred they were proven and immediately available for commercial production. During 1954, the year prior to their transfer, Phillips made substantial jurisdictional wellhead sales from PLA-5 wells and other producers produced and sold gas from the smaller PLAs. As soon as the PNW system was completed in 1956, large volumes of PLA gas began flowing to the gas consumers of the Pacific Northwest. There is no question that these reserves were sufficiently developed to be expeditiously exploited: PNW relied on them as the principal supply for an extensive new pipeline system; lenders relied on them as collateral to finance the construction of the new system; and the Commission relied on them to certificate the new system in the public interest. Plainly, as the Commission found, the PLA transactions resulted in "a series of large-scale sales of natural gas in place," App. 106a, and because these

sales were to an interstate pipeline company for resale in other states they were jurisdictional sales.

The decision below exempts from regulation a large and important category of natural gas wholesales for resale in interstate commerce and is flatly inconsistent with *Phillips* and *Rayne Field*. This erroneous result must be corrected if western gas consumers are to be afforded the protection against exploitation to which they are entitled under the NGA.

THE DECISION BELOW ILLOGICALLY DEPARTS FROM PRIOR PRECEDENT HOLDING THAT DEVELOPMENT DRILLING IS NOT REQUIRED FOR COMMISSION JURISDICTION TO ATTACH TO A LEASE SALE TRANSFER.

The court of appeals erroneously thought that *Rayne Field* required substantial pre-agreement development drilling before a lease-sale could be jurisdictional. That conclusion is wrong as a matter of precedent, sound policy and the economic realities of the natural gas industry.

After *Rayne Field*, the leading case governing the jurisdictional status of lease-sale agreements is *Ship Shoal*. In *Ship Shoal*, the lease-sale transaction at issue involved acreage which, at the time of transfer, had no development drilling at all. There was only one shut-in gas well with no production history in the field at the time of transfer. Nonetheless, Judge Wisdom writing for the court concluded that the Ship Shoal acreage "had reached the stage of proof and development necessary to satisfy the *Rayne* criteria." 370 F.2d at 64.

Despite the lack of development drilling, the *Ship Shoal* court held that the acreage was sufficiently developed for NGA jurisdiction to attach for two reasons that exist even more strongly in this case. First, like PNW, Tennessee (the pipeline buyer in *Ship Shoal*), had demonstrated its faith in the amount of reserves by its willingness to invest large amounts of money and base its application to the Commission for a transmission expansion certificate on the estimated reserves. *Id.* at 65. Indeed, PNW and its investors staked even greater sums and the certificate application for an entirely new pipeline system on the PLA reserves. Second, Tennessee's, like PNW's, readiness "to connect its lines to [the field provided] . . . a strong indication that the field was 'substantially developed' at the time of transfer." *Id.* (footnote omitted.) Here, within 16 months of transfer, PNW's pipeline system from the San Juan Basin to the Pacific Northwest had been built, the PLA reserves were connected and large quantities of PLA gas were flowing in interstate commerce as the principal supply to the new Pacific Northwest market. App. 82a.

In reaching its erroneous conclusion that jurisdiction turns on a well count, the court of appeals reasoned "that the actual number of wells in the ground in comparison to the number needed to complete production from the land is a relevant factor", App. 17a, and found "that the few wells in the ground when the agreements were executed could not have come close to depleting the acreage." App. 16a. The court thus held that the acreage was not "substantially developed" and the lease-sales were not jurisdictional because "the [pipelines'] ability

to tie in a few wells shortly after consummation of the transaction does not demonstrate an imminent ability to produce in *commercial* quantities." *Id.* (emphasis in original.)

That conclusion is plain error. Shortly after consummation of the PLA transfers, commercial quantities of PLA gas were flowing in interstate commerce. Even before consummation of the transfer to PNW, Phillips in 1954 made jurisdictional sales of commercial quantities of gas (1.35 Bcf) from PLA-5.

Moreover, that conclusion ignores the holding of *Ship Shoal*. In *Ship Shoal*, the producers similarly claimed that the lack of development drilling defeated Commission jurisdiction. The Fifth Circuit disagreed:

> It may well be that Ship Shoal is a "long way" from being fully developed. Catco anticipated that from 34 to 40 additional completions would be necessary to calculate the final consideration in the seventh year redetermination of reserves. But this problem relates more to determination of final consideration, than to imminent ability for production. The "substantial and determinative economic fact" is that Catco transferred a large volume of natural gas, definable within a range of reliable engineering estimates, to a jurisdictional pipeline company for imminent interstate transmission.
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> . . . .
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> The crucial fact here, as in *Rayne*, is that the assignment of the leases accomplished the transfer of large amounts of substantially proven off-shore natural gas reserves to an interstate pipeline com-

> pany for eventual resale in interstate commerce. The transaction was a sale of a definable volume of gas, the price of which was geared to the actual volume found, and payment for which was directly related to its production—even if there has also been a transfer of an interest in real property. If such sales were not subject to Commission regulation, an "attractive gap" in the regulatory system would be created, and the producing states would be unable to close it. 370 F.2d at 66-67.

Thus, the decision below is irreconcilable with both the facts and the reasoning in *Ship Shoal*. The court's *sub silentio* rejection of *Ship Shoal* and its mechanical well-counting test make no sense. There is no regulatory significance in the number of development wells existing in a proven field transferred to an interstate pipeline. Producers control the extent of such drilling. They will not invest in any more wells than necessary to establish the proven and available nature of the reserves until the reserves can be connected to a market and sold. Investing in further development drilling without first obtaining a sales commitment would be obviously imprudent.

The court's exclusion from NGA jurisdiction of lease-sales—the form of transaction chosen by PLA and GLA producers over the wellhead sale format to circumvent jurisdiction—in a proven, yet not substantially drilled, field reopened just the regulatory gap *Rayne Field* and *Ship Shoal* endeavored to close. Under the court of appeal's ruling, these major producers, who held large, proven and badly needed reserves in the San Juan Basin, both escape the price regulation they clearly would have been subject to under *Phillips* had they chosen to sell at

the wellhead and shift the cost of drilling and production to interstate pipelines and their gas consumers merely by a change in the form of the transaction. That result exalts form over substance and defeats the policy of the NGA.

CONCLUSION

The decision below is at war with the policies which motivated this Court in *Phillips* and *Rayne Field* and is flatly inconsistent with *Ship Shoal*. It seriously impedes effective administration of the NGA and severely prejudices gas consumers throughout the West. The petition should be granted.

Respectfully submitted,

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